

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Bowen Analyst: Gloria McConnell Bill Number: SB 906  
Related Bills: See Legislative History Telephone: 845-4336 Introduced Date: 02/23/01  
Attorney: Patrick Kusiak Sponsor: Franchise Tax Board

**SUBJECT:** Full Payment Rule

### SUMMARY

The provisions of this bill are sponsored by the Franchise Tax Board (FTB). This bill would allow taxpayers who are making installment payments on their taxes to file a claim for refund before their taxes are fully paid. Such claims are commonly called protective refund claims.

### PURPOSE OF THE BILL

The purpose of this bill is to ensure that taxpayers can file refund claims for overpaid income taxes when the tax was paid through installment payments.

### EFFECTIVE/OPERATIVE DATE

This bill would apply to claims for refund filed on or after January 1, 2002, without regard to taxable year. However, installment payments would only be refunded to the taxpayer if the protective refund claim is filed within the usual statute of limitations (SOL) for claiming a refund. Thus, installment payments made before January 1, 2001, would not be subject to a refund under this bill.

### POSITION

Support.

At its December 18, 2000, meeting, the FTB voted 2-0 to sponsor the language introduced in this bill.

### ANALYSIS

#### FEDERAL/STATE LAW

Under current state tax law and the California Constitution, taxes must be fully paid before the taxpayer can file a refund claim and before that claim can be acted on administratively (protest/appeal) or judicially (court). This is commonly called the "full payment rule." In addition, state law limits the amount that can be refunded to amounts that are paid and for which a claim for refund is filed within the SOL. The SOL is the **later** of:

- four years from the original due date of the return,
- four years from the date the return was timely filed, or
- one year from the date of payment.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

**Gerald Goldberg**

**04/19/01**

Once the SOL has expired, the taxpayer's right to a refund of the overpayment is lost.

Federal case law allows for an informal claim process that holds open the SOL until the tax is fully paid. (The usual federal SOL for claiming overpayments is the later of three years from the date the return is filed or two years from the time the tax is paid.)

### THIS BILL

This bill would allow taxpayers who are making installment payments to satisfy their past tax liability to file a refund claim before their taxes are fully paid.

### IMPLEMENTATION CONSIDERATIONS

There are no significant implementation considerations relevant to this bill. Even though taxpayers could file their protective refund claims before their taxes are fully paid, the department would continue its current practice and act on those claims only when the taxes become fully paid. Because this bill allows the taxpayer to hold the refund SOL open indefinitely, the department may experience some record keeping difficulties, but they are not expected to be significant. In addition, the department's record retention rules would need modifying to recognize the filing of, and retain the records related to, these protective refund claims.

### **OTHER STATES' INFORMATION**

The claim for refund provisions of five of the larger states with tax laws similar to California's were reviewed: Illinois, Massachusetts, Michigan, Minnesota, and New York. These states, which have both personal and corporate tax laws like California, allow taxpayers to file refund claims and have SOLs for making refunds. However, no laws in these states appear to allow the filing of protective claims.

### **FISCAL IMPACT**

#### Departmental Costs

This bill's impact on FTB's departmental costs is unknown, but believed to be minor, if any.

### **ECONOMIC IMPACT**

#### Tax Revenue Estimate

A minor decrease in tax revenue would result from this bill because taxpayers would be able to have amounts refunded that otherwise would be barred under current law.

### **ARGUMENTS/POLICY CONCERNS**

- For taxpayers who are experiencing financial hardship and cannot pay their taxes without making installment payments, California's full payment rule may be unduly harsh. Due to the SOL, these taxpayers may lose the right to obtain the refund of a tax amount that they paid and that are later found administratively or judicially not to be owed to the state.

- This bill addresses a fundamental issue of fairness for taxpayers and may be viewed as good tax policy.
- This bill would allow California taxpayers making installment payments to follow the same refund claim process allowed under federal case law.
- California law allows taxpayers experiencing financial hardships to pay their tax through installment payments and avoid involuntary collection of tax. Therefore, for the law to allow installment payments but then deny a refund of some of the payments because they are beyond the SOL, may be viewed as a trap for the taxpayer. This bill would remove this problem.
- This bill allows the taxpayer to hold the refund SOL open indefinitely, even if only making sporadic payments of a minimal amount and over a lengthy period of time. Permitting protective claims to permanently open the refund SOL is unprecedented.

#### **LEGISLATIVE STAFF CONTACT**

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